RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Nov. 19, 1997 **LETTER 1239**

Nov. 7 DJIA 7581.32; PTI 5102; A-D Ratio +9.47
Nov. 14 DJIA 7572.48; PTI 5104; A-D Ratio +9.16
Dow Yield: 1.78%; Dow Price/Earnings: 19.5
Dow 144-day MA: 7707; Dow 34-day MA: 7608
Dow Times Book Value: 5.35; PTI 89-day MA: 5050
Percentage of Undervalued Blue-chips: 3%
Gold 34-day MA: 318

THE MARKET: This is from the cover of the November 10 *US News & World Report.* It asks the question that every professional and market veteran is asking (of course, the mutual fund public isn't asking the question, since it KNOWS that the market "always ends up higher").

WHAT NOW FOR
INVESTORS
DOES THE AGING BULL HAVE LEGS?
■ What the Rise of Global Markets Means to You
■ The Long-term Prospects for the American Economy

But why be stubborn, why have preconceived notions regarding what must happen next? Honest, there are times when the primary direction of the stock market appears clear and definitive. And honest, this is not one of those times.

Nevertheless, we do know quite a bit about this market. And we do know how to identify certain conditions. So saying, let's begin.

(1) We know that the primary trend of the market was last confirmed as bullish -- that's just basic Dow Theory (the last confirmed trend is always taken to be the prevailing trend). Therefore, we must classify the trend as **bullish until proved otherwise.**

(2) Of course, we are entitled to our suspicions. We know that **the Dow topped out over three months ago** on August 6 at **8259.31**, and we know that the despite the Dow peak, the Transports continued their advance until October 21. The new highs in the Transports were **unconfirmed by the Dow**, setting up a potentially dangerous situation under Dow Theory.

(3) We watched the Dow as, on October 27, it smashed below its previous reaction low of 7622.42. At the same time we noted that the Transports refused by a wide margin to confirm the Dow's downside penetration. The **non-confirmation on the part of the Transports was a major plus,** and it led to the violent but short-lived rally which began on October 28.

(4) The refusal by the Transports to confirm the bearish penetration by the Dow means that a Dow Theory bear market signal was averted, at least for the time being.

(5) My moving average studies of the Dow are still (but barely) in the longer-term bullish mode, meaning that the 34-day moving average of the Dow, although declining daily, is still **above** the 144-day MA (see chart). The chart tells us that the downside action of the Dow has not persisted long enough or been powerful enough to drive the 34-day MA below the longer-term 144-day MA. Of course, this will change if the Dow continues to be weak.

(6) This is very important. **I believe the Dow now holds the KEY to the market's primary direction.** As this is written, the Dow has sunk below both its short-term and long-term moving averages. This implies a good deal of weakness; the question now is whether the Dow will test its October 27 mini-crash closing low of **7161.15.**

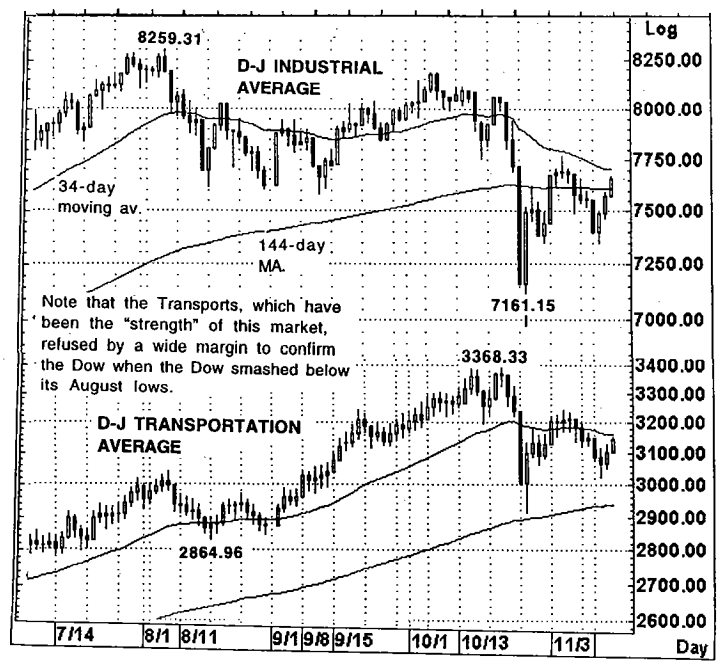
In the stock market, when the strongest segment finally turns weak, that's the market's way of "throwing in the towel." As you know, the **D-J Transportation Average has been the strongest segment of the market.** Therefore, I'm watching this Average with utmost interest.

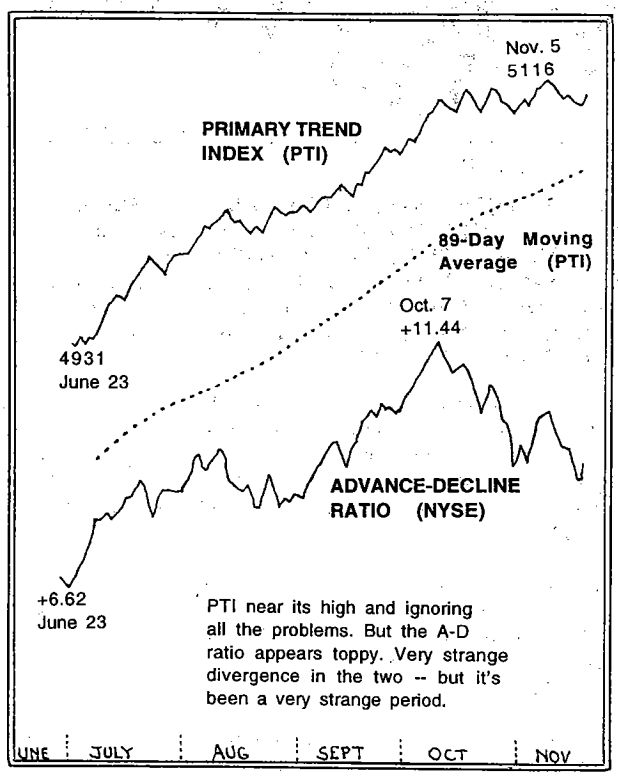
TIME: Time is now an extremely important consideration. **In a bull market, values increase with the passage of time. In a bear market, values erode through time.** More than three months have now elapsed since the Dow recorded its August 6 high. If this is still a bull market, then time will have quietly increased the value of the Dow stocks and the Averages will, in due time, breakout on the upside.

But if the tide has turned and a bear market has stealthily crept in, then the three-and-a-half months since August 6 has decreased stock values, and the eventual breakout of the Averages will be to the downside.

The Russell suspicion -- I consider it bearish that in the face of all the recent mutual fund buying and in the face of widespread optimism, the Dow has failed to record a new high since August 6. I don't like the way things are going.

Question: Russell, what about valuations? You talk about price action, but what about the over-valuation in this market?





Answer: Valuations show you **what phase** a market is in, but valuations can't be used for pin-point timing. If we judged by valuation alone, we'd have said, "Good-bye," to this market years ago. No, in Dow Theory we use price action within the context of overall valuations. We know the market is overvalued, we know the bull market is now in its third or speculative phase. The third phase of a bull market is the phase where a bear market is expected to begin. So we now watch price action to tell us whether the bull market continues or whether the bull is breathing his last.

Question: How about your Primary Trend Index?

Answer: The very recent new highs in the PTI are a plus. They tell me that the bullish forces aren't going to give up easily; no, there is still buying power in this market. Actually, I view the whole area from July to the present as one giant battle between the bulls and the bears, each side stubbornly convinced of its own case -- and backing their opinions with action, the bulls buying heavily and the bears selling heavily.

Let me put it another way -- if the PTI is fated to break below its 89-day moving average, it's going to take persistent, stubborn selling pressure. I never predict what the PTI is going to do. If the bear forces are dominating, the PTI will render a bear signal by breaking decisively below its 89-day MA. If the bull forces dominate, the PTI will continue to hold above its 89-day MA.

Conclusion: So far, although the situation appears dicey to me, I've received no bear signal either from Dow Theory or from my PTI. In other words, this is a bull market until proved otherwise, and the otherwise proof has not appeared yet. However, and this is important, the LONGER the time elapse without a new Dow high, the more I suspect that something is seriously wrong with the bullish scenario.

Question: Russell, for the sake of argument, let's assume that the primary trend is in the process of turning bearish. How do you explain the strength of the Transports in the face of the weak Dow? After all, the Transports are still 125 points above their October 27 mini-crash low and a big 265 points above their critical August 15 low (remember, it would take a Transport close below the August 15 low of **2864.96** to signal a primary bear market).

Answer: Here's one logical explanation. Corporations are still increasing capacity worldwide, but they can't raise prices. Over capacity, over production, and deflation have killed pricing power. This means that corporate profits will slowly be squeezed, a situation which is showing up in a lagging or declining Industrial Average.

On the other hand, corporations will continue to ship goods (even at lower profits), salesmen will continue to travel across the country and around the world, and the public (the last to know if anything is wrong) will continue to pack the airlines as they take their beloved vacation trips.

Thus, the Dow could decline, even while the Transports continue to hold up. However, if business actually starts to deteriorate, at some point it will impact on travel and shipping and the Transports will follow the Industrials down, finally violating their August 15 low of **2864.96**.

Asia: I don't think people (i.e., the markets) have taken the Asian mess seriously enough. For the first time, the US must deal with global markets that can and will impact on the US. The Fed is no longer master of either US interest rates or the US money supply. Today, trillions of dollars change homes instantly via electronic signals. The "Asian Tigers" have turned out to be paper tigers. All have devalued their currencies in a frantic effort to increase exports. Japan, the world's second largest economy, cringes as it watches the free-falls in both the yen and the Nikkei. Tragically, Asia has no lender of last resort. The US provides no leadership, the IMF appears not to know what to do, and the various Asian nations have only one solution -- devalue their currencies.

Meanwhile China, faced with high unemployment and huge over-capacity, could devalue again in an effort to out-export its Asian neighbors. If that happens, all Asia will be faced with another round of devaluations. So far, the trouble has been largely financial, although it's fast becoming economic in Asia. So far the trouble is strictly financial in the US, confined to "hesitant" markets. But in my opinion, the story is just beginning.

INVESTMENT POSITION: Why sweat it, why spend sleepless nights wondering whether it's a bull market or a bear market? Here's the way I look at it. The true primary trend of the market is hidden somewhere in the belly of this market. We just don't know what the direction is -- **yet.**

But as I said earlier, TIME is a critical factor here. In a bull market values increase through time while in a bear market time diminishes values. So honestly, why sweat it? If the bull is still in command, then in due time the Dow and the Transports will break out to new highs. If the tide has turned, if the bull is dying or has died, then the Transports will fade and the Dow will break down.

What do I think? I suspect we're in the very early stages of a primary bear market -- but I can't prove it -- **yet.**

I think, coming up, the problem for everyone is going to be **income**. If a bear market materializes, people are going to face a double whammy -- losses in the prices of their stocks and very little income (well, maybe a mini 1.8% income from their stocks, assuming dividends aren't cut). So somewhere ahead, there's going to be a frantic scramble for **SAFE INCOME.**

If deflation enters the picture, and I think that's at least a possibility, interest rates will be coming down. Short rates could come way down and long rates could break below 6%, even, would you believe, below 5% (remember, in Japan long rates are below 2%).

So what to do? My suggestion (and I've been saying this for months) -- **lock in income via Treasury bonds** (go out 20 years or more) with as much as half of your assets. As for the rest, stay very short with 25%, and with the remaining 25% go out about three years. I'd stay strictly with Treasury paper, which is totally liquid. Why mess with anything else?

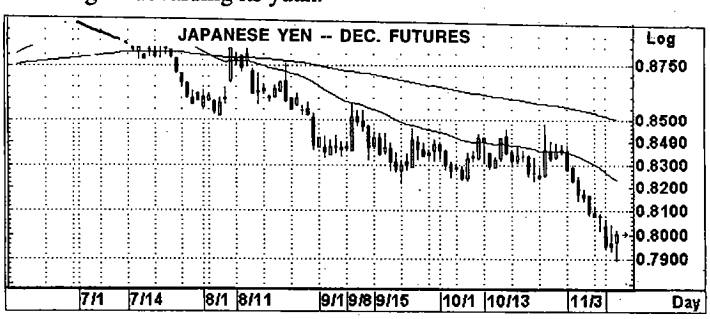
Question: What if there's a liquidity crisis or a worldwide financial crisis? **Answer:** Then you may sweat it for a while with the long bonds, but US Treasuries will remain solvent, they will keep paying, and in the meantime, your short stuff will look great. Furthermore, at or near the bottom of a bear market, prime bonds will recover before stocks.

Note: I've been watching the strength in Utilities. Here's another area of income, and many of the utility stocks have safe, well-covered, much better than average yields. I think investors are buying utilities for the same reason that they are buying bonds. Income, income, income.

Second Note: At today's micro-yields, stocks **must continue to rise.** Knowledgeable investors aren't going to buy stocks with average yields of 1.7% unless they believe those stocks are going to provide them with capital gains. This is the danger of micro-yields. Seasoned investors will not hold these stocks if they believe that the main upward push is over, and they will not hold these stocks in a prolonged trading range. Micro-yield stocks must keep going up.

DEVALUATIONS: One by one, the world's paper currencies are devaluing. Devaluing against what? Devaluing against the world's reserve currency, the dollar. Here are a few of the recent devaluations: the Singapore dollar is down 6%; the S. Korean won is down 8%; the Taiwan dollar is down 23%; the Thai baht is down 44%; the Malaysian ringgitt is down 23%; the Indonesian rupiah is down 33%; and the Philippine peso is down 25%.

And everyone is wondering which currency, if any, goes next. The Japanese yen has not been officially devalued, but it might as well have been. It's been sliding for months, and last week the yen broke to a new low. In the face of vicious competition from other Asian nations the yen is being battered down. Next possible devaluation targets -- South Korea's won (again) and Brazil's real. If the real goes, all of S. America could be in chaos. To stem the pressure, Brazil just instituted tough new austerity measures while raising interest rates. South Korea could also be a huge problem, since S. Korea (with a huge volume of exports) constitutes one of China's fiercest competitors. Finally, the crowning mess would be China again devaluing its yuan.



Recently, the Dollar Index has been weak. This Index is heavily weighted by the D-mark, which has been rising against the dollar. So the question -- why should the German currency be stronger than the dollar? After all, Germany has 12% unemployment (20% unemployment in East Germany), Germany has the highest hourly wages in the world, and Germany has very tough unions and an expensive social system.

Despite domestic problems, the Bundesbank just raised rates -- probably to show how "tough" it is. The Germans, their currency having been twice wiped out by inflation, will accept a recession before they'll accept inflation. Evidently, the world sees the D-mark as a stronger bastion against inflation than the dollar.

Another point is that the US current account (i.e., all transactions, trade and financial) deficit could climb to near $1 trillion in '97. Imports to the US are climbing and if the rest of the world continues to slow down, our exports could slide dramatically.

The answer to the weak dollar vs. the D-mark could also be partly technical -- foreign holders of US securities, for whatever reason (they need the cash?) are repatriating their money, which means selling dollars for yen, D-marks, francs and other currencies, then bringing those currencies back to their own bank accounts.

As for the yen, Japan is now in recession, and the world is wondering whether there will ultimately be a panic to get out of yen-denominated assets. If there is such a panic, we could see the yen collapse, dropping far below its current low levels. Last week Yasyi Matsushita, chief of Japan's central bank, warned that the nation had suffered "a profound and long-lasting" blow from the April tax increase.

Question -- with all these devaluations and with all these nations now exporting "cheap" goods, how long can the dollar hold up? So far, the dollar has been strong against the Asian currencies but weak against the D-mark and particularly weak against the Swiss franc. A swooning dollar would have serious consequences, particularly in the face of hundreds of billions of dollar-denominated assets which are held outside the US.

A plunging dollar would undoubtedly trigger massive foreign selling of US assets and a deflation here in the US. For this reason, the Fed has announced that it stands ready to buy any amount of US Treasury debt if the need arises.

Said David Kadarauch, head of equity research in Jardine Fleming Securities' Seoul office, "There is a severe financial crisis developing here that could be far more serious than anything we've seen in the region. If foreign lenders start refusing to roll over short-term debt in Seoul, which now accounts for about two-thirds of the country's total foreign debt of 110 billion, then the won could easy go down to the 1200 level. But what's really scary is that the Ministry of Finance has been calling people like us asking what they should do. They really don't seem to have any idea of what to do. It could become a real nightmare."

Question: Will the rash of currency devaluations ultimately produce deflation or inflation?

Answer: This is a very tough one, and I don't think anyone really has a clue. Personally, I think the initial effect would be deflation, an effect which we are now getting a hint of. But in time central banks will move to counter-act deflationary forces -- and this means running the money printing presses overtime, which would ultimately produce inflation. That's the way I see it, first deflation and then inflation. One problem -- if deflation is the trend, it can get out of hand as the debt bubbles of the world finally burst.

NOTES & QUOTES: To me, the great irony of the current situation is this -- do you remember how around six months ago all the "experts" were talking about the fabulous DEMAND for merchandise and materials and commodities that would come out of Asia. I kept saying that rather than the great demand, I was afraid of the great potential SUPPLY that would come out of Asia.

And today it's the supply that's worrying world markets. China, Japan, South Korea, the Asian "Tigers," they all want to export. Most of the Asians have over-built their manufacturing capacity. And in their battle to export, the various nations have resorted to competitive devaluations.

13D Research, Inc. [(208)726-1565] notes that the Mexican bailout of $50 billion amounted to 15% of Mexico's GDP. To be comparable, emerging Asia would need a bailout of $180 billion, and if you include China and Hong Kong in the bailout you would

need $310 billion. *13D* also notes that "the entire developed world is very dependent on emerging country growth. Between the fall of Communism and the end of 1996, total exports to the developing world doubled to $1.8 trillion annually. Some 60% of the total came from the developed nations with Japan and the US accounting for nearly half of that. Asia imported nearly $1 trillion worth of goods in 1996. This represented about 60% of total imports of all developing nations." **Russell comment:** If the emerging nations cut back drastically on their imports -- and they will, then the developed nations are going to feel it. It's going to hurt, count on it.

* *

The November 5 *WSJ* notes that "growth in factory capacity so far is the fastest in 28 years . . . a firm that tracks factory additions expects a 40% pickup in the second half of this year over the first six months in announcements for new and expanded plants." Says Merrill Lynch's chief investment strategist, Charles Clough, "The risk to the economy now is overproduction of everything from bagels to athletic shoes to sport utility vehicles." Clough is concerned that the unusually high debt burden carried by consumers has finally begun to rein in spending. Clough adds that the combination of weak sales and booming factory output spells trouble for the economy.

* *

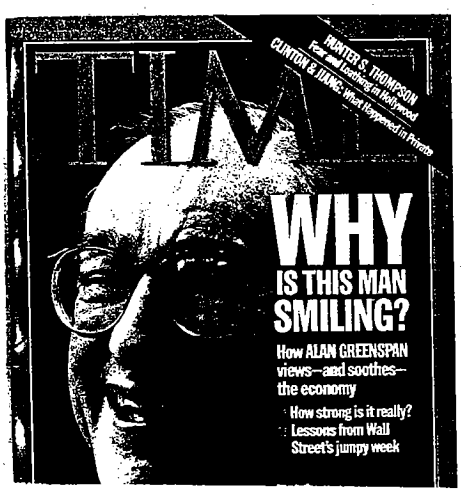
A survey by American Express Financial Advisors of small investors showed that only one of 12 small investors made any changes during the tempestuous week at the end of October. Also, two out of three small investors believe the Dow will be back above 8000 by the end of the year. Nearly half of those polled are more confident in the market today than they were a year ago. **Russell comment:** You may be surprised to know that of the entire US equity market, only 15% is in the hands of mutual funds. The rest is owned by individuals or institutions. The institutions don't change positions very quickly -- it's the individuals who really move the markets either up or down.

* *

I said this years ago, but I'll say it again. The era of major military competition is over; we've now moved into the era of **commercial competition**. The best proof of the end of major military competition is that France and Germany, historically bitter enemies, now have a close relationship and may soon share a common currency. This implies that Western Europe may never again by embroiled in a major war. And believe me, that is progress.

* *

The old adage runs that when a trend or an event becomes so widely-accepted that it makes the cover of *Time* magazine, it's time to take a contrary view. The November 10 cover of *Time* shows a laughing Alan Greenspan and the magazine asks, "Why Is This Man Smiling?" **Russell comment:** Alan, you just got married, you've had a nice time at the Fed, Wall Street hangs on your every word, and it's great that you're laughing. But maybe it's time to retire while you're still ahead. The Russell guess is that the easy part of your reign is over.


HUNTER S. THOMPSON
CLINTON & LEWINSKY: What Happened in Private
WHY
IS THIS MAN
SMILING?
How ALAN GREENSPAN views—and soothes—the economy
How strong is it really?
Lessons from Wall Street's jumpy week

* *

Time Out, New York magazine provides the following test to determine whether you're really a New Yorker. If you're a true New Yorker: **(1)** You rarely look up at the sky. When it rains, New Yorkers say, "Where is that stuff coming from?" **(2)** You hate subway tokens. Subway clerks in NYC are more hated that lawyers, because New Yorkers hate anything that slows them down. **(3)** You rush home to an empty apartment, just in case there's a message on your machine informing you that all your dreams have come true. **(4)** Black is your main color. Black denotes gritty experience and it implies that you buried your naive self when you came here. **(5)** You start wondering what everyone else makes. Your worst competitive nightmare is when you learn how much the head of the Sanitation Dept. makes. Salaries are game scores in NYC.

* *

My ex-wife, Paula, just got delivery on one of the new M-class Mercedes sports utility vehicles. To be brief, she loves the thing, says it rides like a sedan, and it's just, well, perfect. However, it's advertised (assuming you can get one) at around $35,000, but with leather, sky-roof, all the extra plus California tax it runs over 50 grand, which is a lot. One complaint of my own -- it seems that every other vehicle, at least here in Southern California, is either a truck, a van or a sports utility. All this big stuff blocks your view when you're driving around. I feel like a mouse among elephants. What ever happened to just plain cars?

* *

Everybody in Southern California is anxiously awaiting the arrival of the dreaded El Nino, which is supposed to flood us with great torrents of wind and water. So far, at least, we've had the longest, hottest summer I've experienced in 36 years of living here. We had a heat wave here in November with temperatures surging into the high 80s. El Nino, I'm almost hoping for it, if it will bring us a little rain (we've had one insignificant little rain in San Diego the last 230 days). My new name for this town -- Sandy Yeggo.

* *

They say that the division between the poor and the wealthy in the US is growing ever-wider. I believe it. For instance, art prices are zooming up again. At the widely-anticipated auction of the Ganz art collection in NYC, Christie's thought the total auction might bring in around $160 million. It actually brought in $207 million. The Ganz couple bought one Picasso in 1941 for $7,000. It sold for $46 million at the auction. At the same time, the price of diamonds continues to be sky-high. A 5.5-carat orange-colored diamond sold at auction a few weeks ago in NYC for a record $2.3 million. Speaking of diamonds, New York's Museum of Natural History is putting on a huge diamond show (sponsored by DeBeers) entitled, "The Nature of Diamonds." It's a terrific show, the largest display of diamonds ever put together.

Why do wealthy people buy paintings, diamonds, great jewelry, physical gold? Answer: They're all stores of wealth. Currencies collapse, businesses fail, owners die, but El Greco paintings, large diamonds, gold coins, they are physical forms of wealth that outlast depressions, governments, currencies and a thousand disasters. What would you rather leave your great, great grandchild, an original Picasso or five million US dollars? I'll pick the Picasso.

* *

Two major problems confront politicians and maybe voters in the next election. The first problem is the tax system -- question -- should the current system be totally jettisoned and replaced by a flat tax or a consumption tax? The second problem is campaign financing. Both parties like the current campaign financing system, despite their protestations. So it's doubtful whether anything will get done here. As for the current tax system, both parties seem to like the tax system, since it gives them the power to hand out special tax considerations to special groups. On both issues the public remains remarkably complacent. Complacency is a product of the times. When the country is prosperous and people's stomachs are full, they have little desire to change anything, be it a corrupt political system or an outrageous tax system. Maybe, maybe it will take a bear market before America's happy voters and satisfied politicians are ready to make any fundamental changes.

* *

The New York Stock and Exchange Board was founded back in 1817 in a place called Tontine's CoffeeHouse (sorry, Starbucks). Trading was restricted to members, and membership (a "seat") went for $25. By the 1840s, a seat cost $400. By 1960, a seat went for $70,000. Today there are 1,366 seats on the NYSE (actually, there are no seats, these guys stand). Last week a NYSE seat sold for a record $1.5 million.

* *

Good-Byes: My old friend, Irving Weiss, died a few months ago. I first met Irv back in '58, just after I started publishing Dow Theory Letters. Irv was a market student, and a veteran of the great 1929 crash, where he made quite a bit of money on the short side. Irv introduced me to the world of government debt, and more specifically Treasury bills. Irv, always a pioneer, started the first US government bond fund. Irv was also way ahead of his time in diet; he avoided fats and was a vegetarian, living pretty much on raw veggies, nuts and seeds. Irv was enthusiastic about the market right into his 80s. So here's to an old friend and teacher. Good-bye, Irv.

Two weeks ago the long-time editor of *Barron's*, Bob Bleiberg, passed away. Bob okayed my first article for *Barron's* which was published on December 1, 1958. In that piece, entitled "Dow Theory Revisited," I predicted a great bull market, which was against prevailing opinion (the nation was then in a severe recession). Bob told me that that article brought in the most interest of any *Barron's* article in years. That piece was followed by about 30 *Barron's* pieces, and I can say that Bob and *Barron's* literally put me in business. Bob Bleiberg wrote dozens and dozens of brilliant and iconoclastic editorials for *Barron's*. He was a fine editor, a great, inquiring mind, a good friend, honest as the day is long, a constant promoter of free markets, and, well, I could go on and on. So Bob, you were always a prodigious worker -- but here's your chance to forget about the markets for a while and -- rest in peace.

* *

There's little question that many European nations are smarting because the "almighty dollar" continues to be the world's reserve currency. This Associated Press headline tells a bit of the story. Much of Europe would love to have an alternative to the dollar, and they're hoping that the Euro will fit the bill.

French Finance Chief Says Euro May Become Rival To Dollar

By SALLY JACOBSEN
AP Business Writer

NEW YORK — Europe's planned single currency will not replace the dollar as the pre-eminent currency

Germany, France, Italy, Belgium, Luxembourg, the Netherlands, Spain, Portugal, Ireland, Finland and Austria.

France caused a flap last week by

* *

Last week Warren Buffett lectured high school students in Omaha on the process of getting rich, or at least of building income. The "Sage of Omaha" said, "There's nothing like the savings you accumulate before you start raising a family and the bills start coming in. Plus the money will work for you for a longer period of time." Later he repeated, "You have to save. It's the only way you're going to acquire wealth unless you hit the lottery." Buffett told the kids that his investment strategy was simple -- he exhaustively studied the companies he bought and trusted their management. "If I didn't understand something, I wouldn't invest in it," said the sage. **Russell comment:** The royal road to riches **is compounding your savings.** You may not end up as rich as Buffett, but you'll end up with a lot of money. Of course the catch is that you have to save, and you have to understand the power of compounding. One more thing -- you cannot accept large losses.

Students Get Financial Advice From Buffett

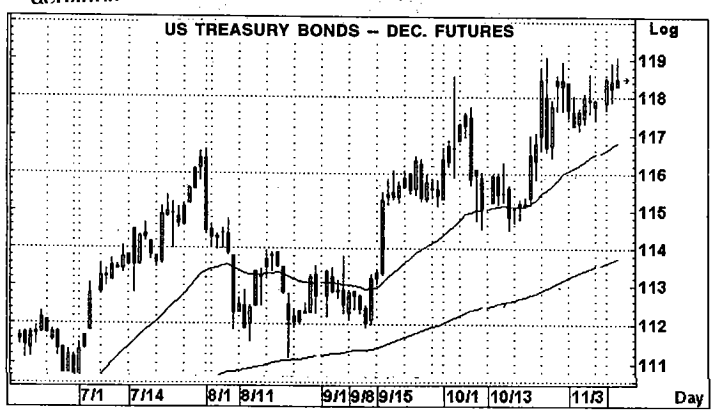
By STEPHEN SOBEK
Associated Press Writer

OMAHA, Neb. — Billionaire investor Warren Buffett has some advice for high school students:

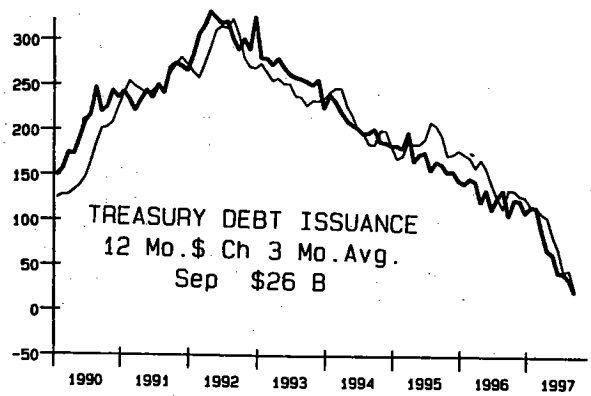
"I want to find out why he's succeeded and use it to my advantage," Christiansen said before the speech.

But Buffett said there was no

BONDS: Last week, on November 13, the long Treasury bonds broke out to new highs. As I see it, big money is now moving in to lock in 6% or slightly better for the long term. Why? They probably see (1) topping out of the stock market, (2) a bear market or (3) deflation.



This chart from Ed Hyman's *ISI* shows that US Treasury debt issuance is crumbling, meaning, of course, that there will be less of a supply of Treasury debt to sell.



Significantly, on the same day that the bonds broke out to new highs, the stock market was down. Thus we are seeing a parting of the ways with bonds rising while the stock market declines.

What does this mean? It means that large investors are choosing bonds with their attractive yields over stocks with their mini-yields. It could also mean that investors see deflation ahead, a condition which would be bullish for bonds and bearish for stocks.

The Predictor: What, hands down, is the best predictor of the economy? It's the difference between the yields on the 10-year Treasury bonds and the 91-day T-bills. This is known as the curve's slope, and it shows the market's perception of the state of the economy. When investors are optimistic, they buy, which in effect pushes yields lower. When they are pessimistic, they sell, driving yields higher.

Normally the curve is somewhat higher at the long end, because at such times investors want more yield to compensate them for holding the bonds over a longer period of time. But when investors start to worry and they feel pressure from the Fed to raise rates, then the bill yield goes up and the slope of the curve starts to flatten out.

Bloomberg magazine provides this chart which gives a gauge of what to expect. The chart shows, for instance, that at a 300 point

differential, the implication is that real growth ahead will be at around 3.9%.

Right now the yield on the T-bills is at 5.25% while the yield on the 10-year note is at 5.85%. Thus the differential is only 0.60%. This is a prediction of around 1% real GDP in the period ahead. Not a very exciting picture for the economy, and the stock market is now acting as if it knows it.

FORECASTING GROWTH

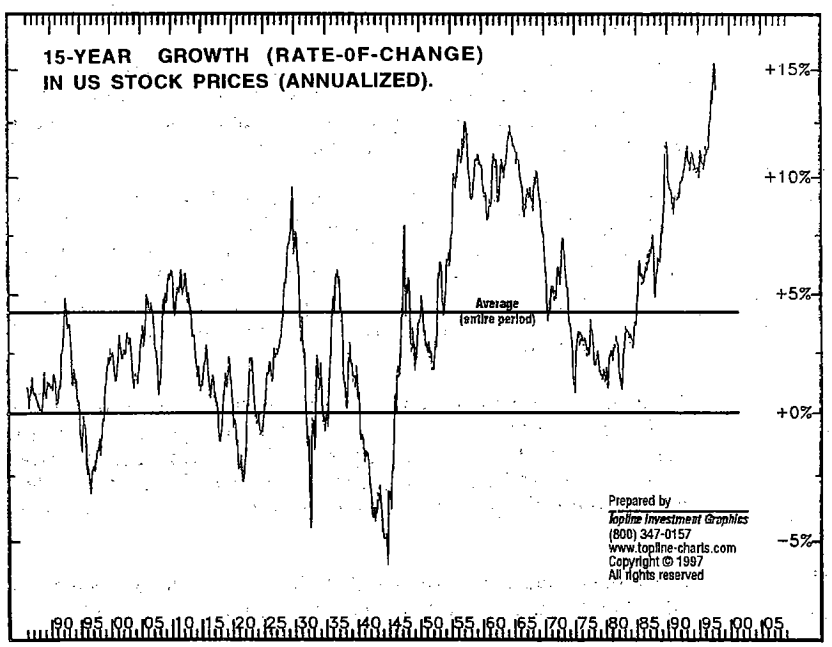
Below are levels of one-year growth implied by the spreads between 10-year and 3-month Treasury yields.

YIELD CURVE	IMPLIED REAL GDP
400 bp	5.2%
300 bp	3.9%
200 bp	2.5%
150 bp	1.8%
100 bp	1.1%
Flat	–0.2%
–100 bp	–1.6%
–200 bp	–2.9%

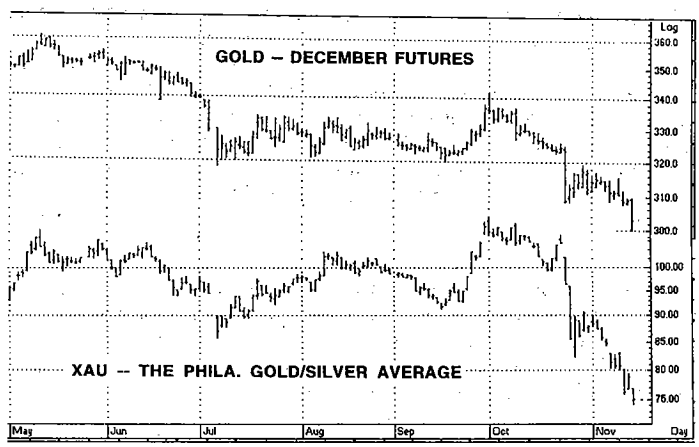
* *

Fed chief Alan Greenspan told the nation in a November 13 speech that the Asian situation should not impact significantly on US business. I have to wonder. From just below 40,000, Japan's Nikkei stock average has now fallen to 15,000, a loss of over 60%. With the world's second largest economy in melt-down, with its stock market in a free-fall, it's hard for me to believe that we'll escape from this only slightly frazzled. On top of that, the *WSJ* (Nov. 14), in a front page article, talks of Japan's small and medium-sized corporations now mounting a major drive to export their goods to the US (up to now, the US only had to deal with Japan's giant companies). To me this spells increased competition in the US, even more vicious lack of pricing power and well, I'll say it again -- DEflation. Many if not most of Japan's large banks are now technically insolvent. A big question is whether any of these banks will declare bankruptcy.

Chart maven John Carder of *Topline* [800 347-1057] just sent me this very interesting chart (bottom of page) of the 15-year rate-of-change (annualized) in US stock prices. Why 15 years? Because that takes in the period of 1982 to the present, which is the period of the greatest appreciation in US stocks in history going back to the 1890s. Writes John, "Current growth rates for stocks are *unprecedented.* Remarkably, the Montgomery survey of their mutual fund investors found that the average investor was looking for a 34% YEARLY return over the next 10 years. With dividend yields under 3%, they're expecting over twice the highest price appreciation ever recorded." **Russell comment**: You might say that the investing public's optimism has risen from super-optimism to spaceville. As I see it, it's possible for the current spike in growth to remain high for a while, but to me it has a "climactic" look. I would guess that over the next few years or more, we will see this spike coming down to earth and heading towards zero.



GOLD: What can you say when you see a twin-chart like this one? It's not a pretty picture. You want me to try to be optimistic? OK, I think (suspect) that what we're seeing is gold moving out of the central banks and into the hands of large, powerful private investors, investors who are accumulating the yellow metal and who intend to hold it come hell or high water. And so far for those who hold gold items, it is hell. Seriously, the anti-gold propaganda is now in full swing, but as I say, there's a point to it. If you're of a mind to accumulate gold, you're not going to laud it -- no, you're going to let it be known that it is no longer a store of value, that it's a relic that's no longer needed, that it's heading for a hundred bucks an ounce. Well, I'm not selling my gold coins and I'm not selling my wife's diamond ring and I'm not selling my house -- so there.



LATE NOTES: I ended the last Letter with the words, "Final Russell Opinion -- Trading range." And increasingly, it looks like this is what we're in for. I added the following: Best bet: the market lapses into a trading range with the Transports refusing to break to new lows and the Dow refusing to advance to new highs."

Ultimately, the trend will be defined either by both the Dow and the Transports advancing to new highs, the Dow above **8259.31** and the Transports above **3368.33** -- or by the two Averages breaking to new lows, the Dow below **7161.15** and the Transports below **2864.96.**

Comment: The Transports have been the "strength" of this market in that they showed so little give when the Dow smashed to its October 27 low. The Transports are now so far above their 2864.96 August 15 low that it's hard to see how we could get a Dow Theory bear signal very soon. Prognosis -- a **broad trading range.**

NEXT MAILING: Dec. 3, 1997